

# CRES POLICY BRIEF



RESEARCH PROJECT ON TOBACCO TAXATION IN  
WEST AFRICA «FISCAL SOLUTIONS FOR MAXIMUM  
REDUCTION OF SMOKING IN WEST AFRICA»



## EFFECTIVENESS OF TOBACCO PRODUCT TAXATION SYSTEMS IN ECOWAS MEMBER COUNTRIES: TAX FRONTIER APPROACH

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### INTRODUCTION

*Taxation is considered the most effective way to reduce the consumption of tobacco products. The World Health Organization (WHO) advocates, for effective tax policy on these products that excise taxes represent at least 75% of the selling price. The ECOWAS countries still have shares of all taxes in the sales price which do not reach 40%. Substantial increases in these taxes could allow them to significantly increase these shares. The new ECOWAS directive, adopted in December 2017, provides, in this sense, a set of measures including an increase in taxes with a mechanism for their regular increase, the introduction of a specific excise tax and the removal of the ceiling on the rates to apply. However each country has a maximum level of tax revenue that it can collect given its wealth; its level of taxation, the efficiency of its administration and its political stability. Thus, before implementing a new tax or increasing the rate of those that exist, each country must analyze the gap between its actual levels of collected revenue and the maximum revenue it can collect. If a country is near its maximum level of taxes, its anti-tobacco fight should be focused mainly on non-tax measures and improving the productivity of the tax administration. On the other hand, if a country is far from its tax capacity, its measures should focus mainly on substantially increasing taxes. It is with the aim of informing this definition of priorities in the fight against tobacco in ECOWAS countries that CRES conducted a research entitled «Effectiveness of tax systems for tobacco products in ECOWAS countries: tax frontier approach ». This policy brief reports on the key results that have resulted.*

### METHODOLOGY

The effectiveness of the tax system on tobacco products in an ECOWAS country is measured by the difference between its effective tax rate and its tax capacity. It is defined as the maximum amount of tax revenue that can be collected by the country given its economic, social, institutional and demographic characteristics. The stochastic frontier method

is used to determine this maximum tax share. The difference, which corresponds to inefficiency, is measured by the error term of the estimate, after deduction of the measurement error. The inefficiency of tax systems for tobacco products is explained by factors relating to the tax system applied by the country (type of tax: ad valorem and / or specific tax, tax base:

manufacturer's price, final sales price exclusive of VAT, etc.) An efficiency frontier was estimated from a sample of 126 countries worldwide. The data come from different sources: CRES survey with the tax authorities of the 15 ECOWAS countries, databases of the WHO, the University of Sherbrooke and the World Bank.

## RESULTS

The maximum level of tax a country can achieve is determined by a few key factors. Low price elasticity of demand, increased government willingness to preserve public health, and a

non-smuggling environment provide a high level of excise revenue capacity in the selling price of cigarettes.

### *An effective share of taxes in selling price is very low*

The actual excise tax shares in the selling price of cigarettes are very small and far from the 70% WHO recommendation (Figure 1). The Gambia and the only country that has its price of selling cigarettes made up of 30% taxes. Outside The

Gambia, only Senegal has 25% taxes in the price. The situation is more worrying for Benin, Guinea-Bissau and Togo, which have a less than 10% tax in the sale price.

### *Few countries have opportunities to have more than 75% of tax share in the selling price*

Looking at countries that potentially meet the 75% WHO target, only Cape Verde, Benin and Ghana are able to do so. The maximum capacities of these countries are respectively 77%,

74% and 70%. Nevertheless, most countries in the sub-region have a maximum share of taxes in the sales price of at least more than 60%.

### *Very low tax efforts*

If we now divide the level of effective tax levy by the level that the country can potentially reach, the results of the estimates show that on the one hand such a tax effort is very low, on the other hand that it varies quite a bit country to another. In the table below, globally the ECOWAS countries are at less than 50% of the possibilities of share of taxes in the price of the tobacco pro-

ducts that they can reach. The Gambia makes 46% of fiscal effort in relation to its tax possibilities. Apart from Senegal and Burkina Faso, all the other ECOWAS countries in the sample used less than 25% of their potential for tax share in the selling price. Guinea Bissau and Benin are even less than 10% of their maximum capacity.

**Table: Share of effective taxes, maximum tax levy capacity, and level of tax effort of ECOWAS countries on tobacco products**

<b>Table: Share of taxes, Tax capacity and tax effort in ECOWAS countries</b>				
<b>Countries</b>	<b>Country Effective tax share (in %)</b>	<b>Tax capacity</b>	<b>Tax gap</b>	<b>Tax effort (en %)</b>
	<b>(1)</b>	<b>(2)</b>	<b>(3)=(2) - (1)</b>	<b>(4)=(1)/(2)</b>
Guinea-Bissau	3	50	46	7
Benin	5	74	69	7
Mali	7	60	53	11
Togo	8	66	58	13
Cape-Verde	12	77	65	16
Liberia	11	61	50	18
Niger	11	60	49	19
Ghana	13	70	56	19
Nigeria	16	67	51	24
Ivory Coast	15	62	47	24
Burkina Faso	17	64	47	27
Senegal	25	65	40	38
Gambia	30	66	36	46

### ***Low performance explained by the tax systems in force***

The estimates we have made show that the low capacity of ECOWAS countries to raise their effective tax rate to the maximum level they could reach is explained by a number of key factors.

- 1) The ECOWAS countries only use ad valorem taxation, whereas the specific one is considered more effective in raising the tax share in the selling price. Gambia, the only country using a specific tax, has the best per-

formance.

- (2) The basis on which the ad valorem excise tax is based is the manufacturer's price declared by the manufacturer. This price does not exceed half of the final sale price. Any tax based on this basis cannot give tax revenue representing a high proportion of taxes in the final price.

## **LESSONS LEARNED AND RECOMMENDATIONS**

### ***Lessons learned***

#### ***Three main lessons can be learned from the results obtained.***

- 1) The first relates to the large difference between actual withdrawals and maximum capacities. The countries of ECOWAS are less than 50% of use of the possibilities of taxation which they have. Thus, the first priority of tobacco control in these countries is the steady increase in taxes.
- 2) An inadequate tax system is prominent among the determinants of the poor performance of the tax levy on tobacco products. The best performance in terms of the share of taxes in the selling price and tax effort are obtained with the application of the specific tax.
- 3) The maximum tax capacity will be improved if the level of productivity of the administration is raised.

### ***Recommendations***

- Continuously increase the ad valorem tax rates in effect.
- Associate a specific tax with the ad valorem tax.
- Use the price exclusive of VAT as a tax base instead of the manufacturer's price.
- Improvement of the productivity of the tax administration.

The International Development Research Center (IDRC) has funded the Consortium for Economic and Social Research (CRES) for the second phase of its research project on the taxation of tobacco products. One of the objectives of this phase was to make the diagnosis of the tax system that the ECOWAS countries apply to tobacco products.

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